United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL

74-1835

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SHATTUCK DENN MINING CORPORATION,

Plaintiff-Appellee-Appellant,

-v.-

WILLARD J. LaMORTE,

Defendant-Appellant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

ANSWERING BRIEF OF PLAINTIFF-APPELLEE-APPELLANT SHATTUCK DENN MINING CORPORATION

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Introductory:

Plaintiff Shattuck Denn Mining Corporation ("Shattuck") recovered below a judgment in the amount of $4,875 against the defendant Willard J. LaMorte ("LaMorte"). La Morte then appealed and Shattuck cross-appealed. Shattuck then as "Appellant" under the FRAP filed its brief and LaMorte as "Appellee" filed his brief. This brief responds to the LaMorte brief.

On pleadings as now constituted, the only issue is as to valuation of the Fireproof shares received by LaMorte and related partnerships on the merger of Fireproof into Shattuck on February 1, 1966. The balance of the issues raised in the LaMorte brief relate to a denial of motions made before Judge Wyatt prior to the trial and to Judge Carter at the time of the trial to amend LaMorte's answer and counter-claim.

POINT I

THE COURT BELOW ERRED IN NOT ADOPTING A VALUATION FOR FIREPROOF SHARES EQUIVALENT TO $7.57 PER SHATTUCK SHARE AND IN ADDING A PREMIUM FOR TRANSFER OF CONTROL

LaMorte's brief argues the theory, shown by Shattuck's former brief to be erroneous, that December 31, 1964, is the critical date for valuation of the Fireproof shares. We continue to submit that this is completely erroneous.

We also continue to submit that the concept of a premium for control is erroneous particularly where, as in this case, both the acquired company and the acquiring company were under common control (see pp. 19 - 20 of the proxy statement with respect to the Fireproof-Shattuck merger, P. ex. 13).

POINT II

THIS COURT HAS FULL JURISDICTION OVER ALL CLAIMS IN THIS LAWSUIT BECAUSE THE STATUTE OF LIMITATIONS DOES NOT BEGIN TO RUN UNTIL THE FACTS ARE DISCOVERED

Shattuck first discovered that LaMorte had been trading in Shattuck's stock in the course of the SEC investigation which began in late April, 1967 (App. 25, 43). And defendant has admitted the allegations of Paragraph "11" of the complaint that -

> "Two years have not elapsed since such profits were realized by defendant, or reports first filed, as required by Section 16(a) of the Securities Exchange Act of 1934, as amended, with respect to the purchases and sales upon which such profits were realized by defendant."

LaMorte now claims that only trades made within a period of two years prior to commencement of this action on August 23, 1967, should have been the basis for payments made by him. It is Shattuck's contention that the two year statute of limitations did not begin to run until it discovered the facts upon which the §16(b) liability was asserted. On Shattuck's theory, therefore, the two year statute of limitations did not begin to run on the trades disclosed in LaMorte's Form 4 (P. ex. 10, August 16, 1967) until sometime between late April, 1967, and the filing of this suit. As a consequence no moneys were paid by LaMorte as the result of mistake.

In Holmberg v. Armbrecht, 327 U.S. 392 (1946), the Supreme Court announced the proposition that into every federal statute of limitations is read the old chancery rule "that where a plaintiff has been injured by fraud and 'remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered, though there be no special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party'." (at p. 397).

The Holmberg rule has been generally followed throughout the federal court system, and particularly in the Second Circuit.

In Westinghouse Electric Corp. v. Pacific Gas & Electric Co., 326 F 2d 575 (9th Cir. 1964), the court said:

> "We believe, where circumstances dictate, the trend is toward applying the fraudulent concealment exception to all statutes of limitation, be they limitations on the right itself or merely on the remedy." (at p. 580).

As stated in the Second Circuit Court of Appeals, in Atlantic City Electric Co. v. General Electric Co., 312 F 2d 236, 240-41 (2nd Cir. 1962), cert. den. 373 U.S. 909 (1963):

> "***As we read the Supreme Court's opinion in Holmberg v. Armbrecht, supra, that policy [tolling by fraudulent concealment] is so strong that it is applicable unless Congress expressly provides to

the contrary in clear and unambiguous language." Accord: Esplin v. Hirschi, 402 F 2d 94 (10th Cir. 1968) cert. den. 394 U.S. 928 (1969), Public Service Co. of New Mexico v. General Electric Co., 315 F 2d 306 (10th Cir. 1963), cert. den. 374 U.S. 809 (1963), Toran v. New York, N.H. & H.R. Co., 108 F. Supp. 564 (D. Mass. 1952), Dabney v. Levy, 92 F. Supp. 551 (S.D.N.Y. 1950).

A thorough discussion of the effect of the §16(b) statute of limitations and application of the tolling doctrine thereto is contained in Grossman v. Young, 72 F. Supp. 375 (S.D.N.Y. 1947). Judge Rifkind in that case considered the bulk of the authorities cited by defendant herein and concluded that the Holmberg doctrine was applicable. The court specifically found that the period of the statute of limitations did not commence until a Form 4 was filed with respect to a particular transaction. The court said (at p. 378):

> "To construe the statute as advocated by the defendant would defeat the principal purpose for which the statute was enacted. The provision of subdivision (a) which calls for the filing of monthly reports and the provisions of subdivision (b) which provide a remedy for the recovery of short-term profits are asserted to be complementary. The former provides the information which is essential for the application of the latter. It is incongruous to permit an insider to escape repayment of his profits by compounding his fault in failing to file the required reports."

In Blau v. Albert, 157 F. Supp. 816 (S.D.N.Y. 1957), the court followed Holmberg and Grossman in holding the §16(b) statute of limitations subject to tolling. And it specifically held (at p. 819) that concealment of trading by an insider (whether intentional or inadvertent) tolled the statute of limitations.

LaMorte's brief (p. 15) argues that there are no facts in the record which would support a finding of fraud, but the answer to this is twofold: (1) actual fraud is unnecessary and (2) he filed false Form 4's between 1963 and 1967 (P. ex. 2 - 9), which did not reflect the transactions which are the basis for this lawsuit.

LaMorte's brief quotes from and relies heavily upon The Harrisburg, 119 U.S. 199, 214 (1886) which stated that a limitation attached to the right to sue is absolute. However, the sentence immediately following the portion of the opinion quoted by defendant is as follows:

> "No question arises in this case as to the power of a court of admiralty to allow an equitable excuse for delay in suing because no excuse of any kind has been shown."

Thus, the quoted language is dictum and, as specifically stated with respect to The Harrisburg by the Supreme Court in Glus v. Brooklyn Eastern District Terminal, 359 U.S. 231, 235 (1959):

> "But that language is in dicta and is neither binding nor persuasive."

It is respectfully submitted that the statute of limitations with respect to the trading of Shattuck's shares by LaMorte and partnerships in which he had an interest did not begin to run until the filing of LaMorte's Form 4 in August, 1967; and that, therefore, this court has full jurisdiction over all claims in this lawsuit.

POINT III

AMENDMENT OF LaMORTE'S ANSWER SHOULD BE DENIED ON THE GROUND THAT SUCH AMENDMENT WOULD SUBSTANTIALLY PREJUDICE PLAINTIFF

The precise nature of LaMorte's proposed amendment to his counterclaim is unclear. In part it may be that he is seeking recovery of amounts previously paid to Shattuck by virtue of his alleged misunderstanding that he was liable for all of the profits of the partnerships rather than just his pro rata share. Leave so to amend would be highly prejudicial to Shattuck.

If LaMorte had counterclaimed promptly for recovery of these amounts Shattuck could have instituted suit against the partnerships themselves for recovery of the profits, on the ground that each partnership was itself a director of Shattuck by virtue of having deputized LaMorte to act as its representative as officer and director of Shattuck, Feder v. Martin Marietta Corp., 406 F 2d 260 (2nd Cir. 1969),

aff'd. 396 U.S. 808 (1970).

In the Feder case one Bunker was chief executive of Martin Marietta, with duties including personal approval of all investments, and a director of Sperry Rand Corporation. Martin Marietta bought and sold shares of Sperry Rand in less than a six month period at a profit and was held liable under §16(b) on the basis that it was a director of Sperry Rand because it had deputized Bunker to act as such for it. The Court observed:

> "....a person in Bunker's unique position could act as a deputy...even in the absence of factors indicating an intention or belief on the part of both companies that he was so acting."

See: Blau v. Lehman, 368 U.S. 403 (1962), Rattner v. Lehman, 193 F. 2d 564 (2nd Cir. 1952).

But Shattuck may no longer bring suit against the partnerships on the theory of deputization because the applicable two year statute of limitations under §16(b) has run.

While it is true that Judge Carter specifically found (App. 403) that there "was no deputization in this case", this is not precisely the point, nor was this point properly an issue tried before Judge Carter. The issue was better formulated by Judge Wyatt (App. A-103):

> "The proposed amendment would add to the counterclaim three new theories of error in the computation of short swing profits already paid

by defendant. These are (1) that he paid profits on which the statute of limitations was a bar, (2) that he paid all the profits made by four family partnerships rather than his distributive share, and (3) that he paid profits on transactions matched within more than six months.

"The proposed amendment would add new issues of fact and law at a time when all discovery has been completed and the action is on the trial calendar. The proposed amended answer was tendered almost three years after the answer was served. There is a dispute whether defendant was represented by counsel when he made a payment of profits to plaintiff. However this may be, it is clear that when the answer was filed he was represented by competent counsel, especially familiar with the facts because they had represented defendant during a background investigation by the Securities and Exchange Commission.

"The introduction of the four family partnerships greatly complicates the issues of fact. In three of these partnerships, two persons outside the family appear for minority interests. In all other respects, these partnerships seem merely an extension of defendant himself. It also appears that Shattuck could have sued all the other partners, had this point been raised when the answer was served. They now have the defense of the statute of limitations and plaintiffwould be prejudiced by the amendment.

"Under the circumstances, the proposed amendment should not be allowed; it is untimely." (Emphasis supplied)

The rule in this circuit is that leave to amend should be denied where the amendment would cause substantial prejudice to a party to the action, Strauss v. Douglas Aircraft Co., 404 F. 2d 1152 (2nd Cir. 1968); see Ricciuti v. Voltarc Tubes, Inc., 277 F. 2d 809 (2nd Cir. 1960).

The Strauss case is particularly applicable because it involved a delay of four years in raising a statute of limitations defense, where the plaintiff could have changed the forum if the defense had been timely filed. The court said (Id., 1155):

> "If the defense [of the statute of limitations] lurks in the case, vacillation can cause the other party irreparable injury."

This, of course, was the basis for the denial of LaMorte's previous motions for leave to amend.

POINT IV

DEFENDANT LaMORTE IS LIABLE FOR THE FULL PROFITS MADE BY THE PARTNERSHIPS ON TRANSACTIONS IN SHATTUCK'S STOCK

The partnerships consisted of the following (App. 193):

> Willard J. LaMorte Agent
> Willard J. LaMorte Partnership
> Joint Stock Traders
> Sanford Boulevard Venture

The Joint Stock Traders and Sanford Boulevard Venture were both merged into the Willard J. LaMorte Partnership (App. 195, 196-97).

As shown in the LaMorte affidavit submitted before Judge Wyatt (App. A-21-23) La Morte, his wife and children had a 100% interest in the "Willard J. LaMorte, Agent"

partnership; LaMorte, his father, brothers and sister held some 80% of the interest in the "Willard J. LaMorte Partnership"; LaMorte, his father, brothers and sister held some 86% of the interest in the "Joint Stock Traders" partnership; and LaMorte, his father and brother held a 75% interest in the "Sanford Boulevard Venture" partnership.

Dugald A. Cameron, who had an interest in the Willard J. LaMorte Partnership, testified that from 1964 Mr. LaMorte acted for the Partnership. And Mr. LaMorte primarily made the investment decisions (App. 199-200), as one might expect, with respect to all the partnerships.

Mr. LaMorte testified (App. 204) that, with respect to the Partnership, he would make the investment decisions in 1963 and "as each year progressed I would make more and more of the investment decisions pertaining to securities."

Mr. LaMorte's method of dealing in securities for the partnerships was somewhat peculiar, to say the least, as was his testimony regarding this aspect of the case. When asked (App. 221) whether he did occasionally open partnership accounts in names other than himself, he answered "I don't recall any, sir." He was then led to admit that he had partnership accounts in the names of his brother-in-law, J. W. Lyons, in Canada (App. 222 - 23) and

that the Lyon's account was transferred at one point to the Bahamas (App. 235 - 36). Mr. LaMorte was further led to admit (App. 230) that there were two partnership accounts at Schweickart, a New York broker-dealer, one in the name of William F. LaMorte Special and the other in the name of Willard J. LaMorte. Mr. LaMorte had authority to deal in either account (App. 230) and, in fact, although his father also had authority the defendant LaMorte was the only person to exercise authority over these accounts (App. 243 - 44). In Canada, Mr. LaMorte also opened partnership accounts in the name of Fred Wepf (App. 244 - 46). Securities of the partnerships were held in street name (App. 209) subject, of course, to the authority of Mr. LaMorte, who also made decisions with respect to voting securities held by the partnership (App. 210).

Mr. LaMorte's credibility should be highly suspect in view of his reluctance to admit anything until it was called to his attention that he had previously testified on the particular subject before the SEC. For example (App. 244), when asked whether he recalled an account opened in the name of Fred Wepf he said "Does it say it in there?" (referring to the SEC testimony). And when asked another question (App. 237) Mr. LaMorte said "If it says it, why, I would say it is true, then, sir" (again referring to the SEC testimony).

In view of the foregoing, LaMorte was the "beneficial" owner of the shares held by the Partnerships. LaMorte had full trading authority to act for the Partnerships in all respects without consultation or approval of other partners and he had voting power of all the stock held in the names of the Partnerships. These are substantial benefits of ownership and should be held to be the equivalent of beneficial ownership.

See Marquette Cement Mfg. Co. v. Andreas, 239 F. Supp. 962, 967 (S.D.N.Y. 1965):

> "Whether [the insider] held a beneficial interest in that stock [of the family trust] is a question of fact to be determined from all the evidence."

See also, Sec. Ex. Act Rel. 7793 (1966), 17 CFR 241.7793 which was published to clarify the meaning of "beneficial ownership of securities" and which points out that a person may be deemed a "beneficial owner" if he obtains therefrom "benefits substantially equivalent to those of ownership." And see: V Loss, Securities Regulation (Supp. to Vol. II), pp. 3063 - 3066.

We submit that the requirements of §16(b) should not be permitted to be evaded by establishment of separate trusts for primarily the same beneficiaries and then trading by the respective trusts in such manner as to avoid the six

month limitation, even though ending up with the same profits.

In Walet v. Jefferson Lake Sulphur Co., 202 F. 2d 433, 434 (5th Cir. 1953), it was held that the husband, in a community property state, nevertheless is liable for the full amount of profits made in the course of short-term trading of the stock of the plaintiff corporation -

> ". . . because the husband, under the law of Louisiana, is the head and master of the community and as such must be held accountable for his management thereof to the same extent as if it were his own."

Similarly, it was held in Mouldings, Inc. v. Potter, 465 F. 2d 1101, reh. den. en banc, 465 F. 2d 1106 (5th Cir., 1972), cert. den. 35 L. Ed. 2d 591, February 20, 1973, that profits realized by the designee of an insider were fully recoverable from the insider. The Court, where the insider sought to transfer profits from his account to the accounts of his designee, made the following observation:

> "Section 16(b) requires the payment over of any 'profit realized'. This terminology is sufficiently broad to cover the transaction here in question. Potter realized the profits for the purpose of controlling them for delivery to his designees."

For much the same reasons as given for the Mouldings decision, defendant's argument should not prevail that purchases and sales of a given partnership may not be matched against purchases or sales of another partnership. Such a

theory would enable an insider much too easily to evade the kind of liability Section 16(b) specifies. An insider could almost totally evade liability simply by creating multiple partnerships.

CONCLUSION

For all of the foregoing reasons, including the reasons stated in our principal brief, the judgment below should be reversed and Shattuck awarded damages in the amount of $31,053.20, with pre-judgment interest and costs.

Respectfully submitted,

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STATE OF NEW YORK)
: SS:
COUNTY OF RICHMOND)

ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 28 day of November, 1974 deponent served the within reply brief upon FELDSHUH ~~KRUK~~ & FRANK

attorney(s) for appellee

in this action, at 144 E. 44th St., NYC 10017

the address designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

Robert Bailey
.....
ROBERT BAILEY

Sworn to before me, this
28 day of November, 1974

William Bailey
WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976